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In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-604

MOUNTAIN FUEL SUPPLY COMPANY,
WEXPRO COMPANY, and
ALEX OBLAD, HAROLD BURTON, and
CARLYLE HARMON,

Petitioners,

v.

UTAH COMMITTEE OF CONSUMER SERVICES and
UTAH DEPARTMENT OF BUSINESS REGULATION,
DIVISION OF PUBLIC UTILITIES,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
SUPREME COURT OF THE STATE OF UTAH

REPLY BRIEF OF PETITIONERS

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REPLY BRIEF OF PETITIONERS

Respondents' brief removes any possible doubt that Utah has violated fundamental constitutional rights that should be vindicated by this Court through the grant of certiorari.

Respondents rely entirely upon one flat factual misrepresentation. Respondents thus implicitly concede (as they must, under the precedent of this Court) that, if the

fact is as petitioners have stated it, Utah has imposed an undue burden upon interstate commerce, impermissibly interfered with federal energy regulatory law, and taken petitioners' property without just compensation.[1]

The factual misrepresentation is respondents' assertion that Mountain Fuel's gas ratepayers took the risk of Mountain Fuel's exploration for oil so that the oil properties "are and always have been" utility assets. If that were true, then Utah's decision to appropriate all oil profits above a utility rate of return would, at least arguably, not violate petitioners' constitutional rights.

But the factual assertion of respondents is obviously false, and Utah may not disguise its interference with commerce and federal regulation as well as its taking of property by simply announcing that any properties it chooses to appropriate are instantaneously "utility" assets. That semantic maneuver, if permitted to succeed, would leave both federal regulatory power and private property rights empty constitutional shells.

1. *Respondents' Factual Misrepresentation: Ratepayer Risk.* The record on this matter is clear and unambiguous. The gas utility customers of Mountain Fuel never paid for Mountain Fuel's oil exploration and development program and never took any risk with respect to that program. The

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[1] While normally this Court does not sit to decide factual questions, that rule gives way when the fact is both easily ascertained and its determination essential to the preservation of basic constitutional rights. Indeed, constitutional rights and this Court's reviewing function are rendered meaningless if a respondent can defeat certiorari by misstating a single crucial fact.

claim of beneficial ownership in revenues from the oil properties is, therefore, utterly groundless.

The facts are:

(a) The Utah Commission made it plain throughout the life of Mountain Fuel's exploration and development program that an exploration expense would be recognized in the gas rates only so long as the program brought to the utility ratepayers gas at a cost-of-service price below the price of comparable field or pipeline supplies. Ratepayers bore no risk because the utility operations would recover no exploration expense if the program were not successful.[2]

(b) The notion that a ratepayer, in purchasing natural gas from Mountain Fuel, took a "risk" or

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[2] Respondents' characterization of this statement as "wholly false" (Resp. Br. 12) is quite remarkable. In addition to the categorical statements by the Utilities Commission in *Utah P.S.C. Case No. 4797* (1960) (R.5639) and *Utah P.S.C. Case No. 5907* (1968) (R.5663) that "a vigorous exploration and development program should be continued so long as the cost incurred in developing new supplies of gas are lower than the average cost of purchased gas," the Utah Commission stated in the 1978 *Case No. 76-057-14*:

> The risks of success of the exploration and development program are burdens which, in the first and last analyses, we place on the Company and its shareholders. If the program is unsuccessful or unproductive and does not yield new low cost natural gas reserves, it is not the utility customers that must account for such, but rather it is the Company, its management and its owners who must shoulder responsibility . . . . (See App. B29 to our Petition)

Even more remarkable is the claim of respondents that petitioners have raised the Utilities Commission's long-announced policy on "ratepayer risk" for the first time in this Court. (Resp. Br. 12) In addition to extended presentation before the Utah Commission, the matter was placed directly before the Utah Supreme Court by Mountain Fuel in its main brief, pages 73-74, under the title "The Gas Customers Have Never Assumed the Risk of the Company's Exploration and Development Program."

made an investment in the exploration and development program of the Company, is absolutely devoid of any evidentiary support in the record and contradicts fundamental precepts of the American economy. "Ratepayer risk" is nothing more than a slogan invented by respondents before the Commission below.

(c) Shareholders, not ratepayers, paid all of the capital costs of oil and gas exploration and development. These costs are not and have never been reimbursed in the rates, and capital losses have always been borne entirely by the shareholders.

(d) Respondents allege that Mountain Fuel's oil and gas exploration has always been carried on as a public utility function. (Resp. Br. 5-6) It clearly has not. A vigorously competitive, high risk business venture, Mountain Fuel's program was only a utility function to the extent that the Utilities Commission made it one by its allowance of an exploration expense in utility rates and its inclusion of gas producing properties in rate base.

Exploration expense for oil property was never reflected in the rates and the oil business was consistently treated as and ordered to be an independent, unregulated function of Mountain Fuel.

Expenses of joint exploration are shared by the non-utility (Wexpro) and utility divisions because the program produces both oil and gas. It is uncontroverted that prior to 1972 the non-utility oil division paid a slightly larger proportion of the exploration expense than the proportion of revenues it received from the program. Correspondingly, the utility gas division paid a proportion of exploration expense slightly smaller than its share of total oil and gas

revenues.[3] Since 1972, the Utilities Commission has adjusted the share of expenses that may be paid by Mountain Fuel's utility division, and hence reflected in gas rates, according to the continuing experience of the Company in the proportions of gas and oil found. The Utilities Commission currently will not permit the utility division to pay more than 50 percent of expenses, although in recent years more gas than oil has been found, so that the non-utility oil business has been subsidizing the utility gas business.[4]

From its earliest examination of rate base in 1940, the Utilities Commisison has *strictly and consistently required* Mountain Fuel to keep its oil properties and investment out of rate base.[5]

It is manifest that the Utilities Commission regarded Mountain Fuel's exploration program as a utility function only to the extent of gas discoveries

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[3] Petitioners are at a loss to account for respondents' reckless assertion that Mountain Fuel ratepayers paid for "all unsuccessful exploration—every single dry hole." (Resp. Br. 9) Not only did the ratepayers not pay for all unsuccessful exploration, the utility division paid even less than its proportionate share. Exhibit MFS-8 (R. 3688), relied upon also by respondents, manifests that from 1960-1976, the shareholders paid $11.8 million more than the Commission authorized for utility exploration expense, alone, not to mention all of the exploration expense of the non-utility division. Even respondents' Exhibit DIV-1 (R. 3675) reflects that between 1966-1972, the non-utility oil division paid 3.4% of joint dry hole exploration at a time that oil revenues were 3.7%. (As pointed out earlier, for the larger 11-year period 1960-1970, the non-utility proportion of joint dry hole expense was 3.2% while proportionate oil revenues were 3.1%.) (R. 3792[8], 3800[24], 5723) For the four-year period 1973-1976, the oil operations bore 46% of joint dry hole expense.

[4] Since Wexpro was created in January 1977, it has paid one-half of all joint exploration expenses. Yet in the last two years, the joint program of the two companies has discovered 55 gas wells and no oil wells. (See 1977 and 1978 Annual Reports of Mountain Fuel Supply Company)

[5] *Re: Mountain Fuel Supply Co.*, 33 P.U.R. (N.S.) 3, 13-14 (1940); *Utah P.S.C. Case No. 4392* (1957) (R. 5615-16); *Utah P.S.C. Case No. 5907* (1968) (R. 5706-07)

and expectations of gas discoveries based on recent historical performance. Thus, even under the illusory "ratepayer risk" theory of respondents, the risk could only have been with respect to gas and not oil.

It therefore follows ineluctably that the ratepayers were completely insulated from any risk associated with exploration for oil. If, as respondents insist, "gain follows risk," Mountain Fuel's shareholders have always been, and are now, entitled to the full unregulated revenues from the non-utility oil properties.

That same conclusion is compelled, as we have shown in our petition, by the specific Utah statute, Utah Code Ann. § 54-2-1(30) (1974), by the consistent practical construction of that statute by Utah for forty years, and by repeated, final orders of the Utilities Commission classifying the very oil properties in question as non-utility assets.

2. *Interference with Interstate Commerce.* Respondents claim that we are wrong to read the Utah court's opinion as regulating the price at which Wexpro may sell gas from independently developed acreage to Mountain Fuel. (Resp. Br. 23) That our statement is accurate is shown by the following language of the Utah opinion itself: "Under the amended purchase and sale agreement, there is a provision for Mountain Fuel to purchase, at *market price* rather than cost-of-service, the gas discovered on properties acquired by Wexpro, *other than transferred acreage and that which comes to it under the joint exploration agreement.* This provision *violates* the 'no-profits-to-affiliates' rule." (See App. A5-6) (Emphasis added) It is palpably clear, therefore, that Utah intends to regulate directly the price of gas sold in interstate commerce.

Respondents' denial that Utah will regulate the profits on interstate sales of oil is incomprehensible. Respondents

state, "[A]ll the Utah Supreme Court held with regard to Mountain Fuel's oil profits is that net profits beyond all costs associated with production, including the cost of capital, from oil developed as a utility activity at the sole risk of ratepayers, should benefit Utah's ratepayers. This is rate-making, not regulation of production, price or profit." (Resp. Br. 26-27)

The fallacy of this contention has already been demonstrated. Respondents contend that all oil was developed at the sole risk of the ratepayers, whereas, as shown above, no oil was. The Utah Supreme Court's holding that all profits above a low utility rate of return should be taken from Wexpro and given to Mountain Fuel's gas ratepayers, therefore, is precisely a regulation of the profits on interstate sales of oil resulting in a burden on commerce so intolerable that the commerce will be required to terminate.

3. *State Interference with Federal Regulation of Oil and Gas.* Respondents attempt to avoid the force of petitioners' preemption argument by overstating it. Petitioners' argument is not that the states are without authority to regulate some administrative aspects of oil and gas production such as well-head spacing, but that states may not regulate the prices or rates of return on oil or gas sales in or affecting interstate commerce, because those subjects are completely preempted by federal law. Respondents, understandably, would rather talk about something else. Thus, they cite an obscure section of the federal Public Utility Regulatory Policy Act of 1978, which leaves the states free to regulate utility advertising and termination of service to customers for non-payment of bills.[6] (Resp. Br. 30-31) This provision has nothing to do with state regulation of natural gas prices and oil profits.

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[6] *See,* 15 U.S.C. §§ 3201-3211 (Supp. 1979)

The demonstration in our petition that prices and profits on oil and gas sales in interstate commerce are now exclusively matters of federal regulation is, we continue to submit, unassailable.

4. *The Taking of Petitioners' Property.* Respondents contend that petitioners have lost nothing under the Utah Supreme Court holding because they still have retained their capital investment in the non-utility oil properties. (Resp. Br. 20-21) The appropriation of petitioners' oil profits, however, slashes the value of that oil investment. One who is left with title to property, after being stripped of most of its value, has suffered an unconstitutional "taking" in the only meaningful sense of that term. *U.S.* v. *Causby,* 328 U.S. 256 (1946).

It is disingenuous to argue, as respondents do (Resp. Br. 17), that the taking here is not retroactive because Utah will appropriate only future revenues. The appropriation of future revenues is the appropriation of most of the capital value of the property, and hence of investments made in prior years.

If words mean anything, the sudden reclassification in 1979 of petitioners' oil properties from a non-utility oil to a utility gas status, thus destroying legitimate, investment-backed expectations, is retroactive. In this case, Utah did not say future investments will be treated in this way. It said *past investments*, made in specific reliance upon established and well-understood rules, will now be treated in a newly invented way. That is retroactive.

5. *Other Accusations of Respondents.* The misstatements and demagogic characterizations in the respondents' opposition brief are several, but this is not the time to engage in a point by point retort.

One thing remains certain for certiorari consideration. This is not a once in a lifetime case. Investor-owned utilities throughout the United States have unregulated, non-utility businesses whose assets will lure "consumerists" as Mountain Fuel's investor-owned oil has lured respondents. If Utah's attempt succeeds, other state and local governments will inevitably expropriate private property rights in order to subsidize even lower consumer utility rates, resulting in the obstruction of interstate commerce and the frustration of uniform national energy policy.

CONCLUSION

A writ of certiorari should be granted to the Supreme Court of Utah to review its order of May 10, 1979.

Respectfully submitted,

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